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**In the Supreme Court of the United States**

No. 628.

OCTOBER TERM, 1964.

UNITED STATES OF AMERICA,  
*Petitioner,*

vs.

MIDLAND-ROSS CORPORATION,  
*Respondent.*

**APPENDIX TO BRIEF FOR RESPONDENT.**

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**APPENDIX.****INTERNAL REVENUE CODE OF 1939.****Gross Income—Definition.**

**Sec. 22. (a) GENERAL DEFINITION.**—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. In the case of Presidents of the United States and judges of courts of the United States taking office after June 6, 1932, the compensation received as such shall be included in gross income; and all Acts fixing the compensation of such Presidents and judges are hereby amended accordingly. In the case of judges of courts of the United States who took office on or before June 6, 1932, the compensation received as such shall be included in gross income.

(26 U. S. C. 1952 ed., Sec. 22.)

**Sec. 42. Period in Which Items of Gross Income Included.**

\* \* \* \* \*

(b) **Noninterest-Bearing Obligations Issued at Discount.**—If, in the case of a taxpayer owning any non-interest-bearing obligation issued at a discount and redeemable for fixed amounts increasing at stated intervals or owning an obligation described in paragraph (2) of subsection (d), the increase in the redemption price of such obligation occurring in the taxable year does not (under the method of accounting used in computing his net in-

come) constitute income to him in such year, such taxpayer may, at his election made in his return for any taxable year beginning after December 31, 1940, treat such increase as income received in such taxable year. If any such election is made with respect to any such obligation, it shall apply also to all such obligations owned by the taxpayer at the beginning of the first taxable year to which it applies and to all such obligations thereafter acquired by him and shall be binding for all subsequent taxable years, unless upon application by the taxpayer the Commissioner permits him, subject to such conditions as the Commissioner deems necessary, to change to a different method. In the case of any such obligations owned by the taxpayer at the beginning of the first taxable year to which his election applies, the increase in the redemption price of such obligations occurring between the date of acquisition (or, in the case of an obligation described in paragraph (2) of subsection (d), the date of acquisition of the series E bond involved) and the first day of such taxable year shall also be treated as income received in such taxable year.

(c) Short-Term Obligations Issued on Discount Basis.—In the case of any obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, the amount of discount at which such obligation is originally sold shall not be considered to accrue until the date on which such obligation is paid at maturity, sold, or otherwise disposed of.

\* \* \* \* \*

(26 U. S. C. 1952 ed., Sec. 42)



**Sec. 111. Determination of Amount of, and Recognition of, Gain or Loss.**

(a) **Computation of Gain or Loss.**—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

\* \* \* \* \*

(26 U. S. C. 1952 ed., Sec. 111)

**Sec. 113. Adjusted Basis For Determining Gain or Loss.**

(a) **Basis (unadjusted) of Property.**—The basis of property shall be the cost of such property; except that—[exceptions not applicable].

\* \* \* \* \*

(b) **Adjusted Basis.**—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) **General Rule.**—Property adjustment in respect of the property shall in all cases be made—

\* \* \* \* \*

(H) in the case of any bond (as defined in section 125) the interest on which is wholly exempt from the tax imposed by this chapter, to the extent of the amortizable bond premium disallowable as a deduction pursuant to section 125 (a) (2), and in the case of any other bond (as defined in such section) to the extent of the deductions allowable pursuant to section 125 (a) (1) with respect thereto.

\* \* \* \* \*

(26 U. S. C. 1952 ed., Sec. 113)

**Sec. 117. Capital Gains and Losses.**

(a) Definitions.—As used in this chapter—

(1) Capital Assets.—The term 'capital assets' means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

\* \* \* \* \*

(D) an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue.

\* \* \* \* \*

(f) Retirement of Bonds, etc.—For the purposes of this chapter, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor.

\* \* \* \* \*

(26 U. S. C. 1952 ed., Sec. 117)

**Sec. 125. Amortizable Bond Premium.**

(a) General Rule.—In the case of any bond, as defined in subsection (d), the following rules shall apply to the amortizable bond premium (determined under subsection (b)) on the bond for any taxable year beginning after December 31, 1941:

(1) Interest Wholly Or Partially Taxable.—In the case of a bond (other than a bond the interest on which is excludable from gross income), the amount of the amortizable bond premium for the taxable year shall be allowed as a deduction.

(2) **Interest Wholly Tax-Exempt.**—In the case of any bond the interest on which is excludable from gross income, no deduction shall be allowed for the amortizable bond premium for the taxable year.

(3) **Adjustment of Credit in Case of Interest Partially Tax-Exempt.**—In the case of any bond the interest on which is allowable as a credit against net income, the credit provided in section 25 (a) (1) or (2), or section 26 (a), as the case may be, shall be reduced by the amount of the amortizable bond premium for the taxable year.

(26 U. S. C. 1952 ed., Sec. 125)

#### **Sec. 201. Life Insurance Companies.**

(e) **Amortization of Premium and Accrual of Discount.**—The gross income, the deduction provided in section 201 (c) (7) (A) and the credit allowed against net income in section 26 (a) shall each be decreased by the appropriate amortization of premium and increased by the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures or other evidences of indebtedness held by a life insurance company. Such amortization and accrual shall be determined (1) in accordance with the method regularly employed by such company, if such method is reasonable, and (2) in all other cases, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary.

\* \* \* \* \*

(26 U. S. C. 1952 ed., Sec. 201)

#### **Sec. 207. Mutual Insurance Companies Other Than Life or Marine.**

\* \* \* \* \*

(d) **Amortization of Premium and Accrual of Discount.**—The gross amount of income during the taxable year from interest, the deduction provided in subsection (b) (4) (A), and the credit allowed against net income in

section 26(a) shall each be decreased by the appropriate amortization of premium and increased by the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures or other evidences of indebtedness held by a mutual insurance company subject to the tax imposed by this section. Such amortization and accrual shall be determined (1) in accordance with the method regularly employed by such company, if such method is reasonable, and (2) in all other cases, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary.

\* \* \* \* \*

(26 U. S. C. 1952 ed., Sec. 207)

#### **Sec. 211. Tax on Nonresident Alien Individuals.**

\* \* \* \* \*

(B) Capital gains of aliens temporarily present in the United States.—In the case of a nonresident alien individual not engaged in trade or business in the United States, there shall be levied, collected, and paid for each taxable year, in addition to the tax imposed by subparagraph (A)—

(i) if he is present in the United States for a period or periods aggregating less than ninety days during such taxable year—a tax of 30 per centum of the amount by which his gains, derived from sources within the United States, from sales or exchanges of capital assets effected during his presence in the United States exceed his losses, allocable to sources within the United States, from such sales or exchanges effected during such presence; or

(ii) if he is present in the United States for a period or periods aggregating ninety days or more during such taxable year—a tax of 30 per centum of the amount by which his gains, derived from sources within the United States, from sales or exchanges of capital assets effected at any time during such year exceed his losses, allocable

to sources within the United States, from such sales or exchanges effected at any time during such year.

For the purposes of this subparagraph, gains and losses shall be taken into account only if, and to the extent that, they would be recognized and taken into account if such individual were engaged in trade or business in the United States, except that such gains and losses shall be computed without regard to the provisions of section 117 (b) and such losses shall be determined without the benefits of the capital loss carry-over provided in section 117 (e).

\* \* \* \* \*

(26 U. S. C. 1952 ed., Sec. 211)

#### **U. S. TREASURY REGULATIONS 118 (1939 CODE).**

##### **§ 39.201-1 Tax on Life Insurance Companies.**

(b) The net income of life insurance companies differs from the net income of other corporations. See section 201 (c). Life insurance companies are entitled, in computing normal-tax net income and corporation surtax net income, to the credits provided in section 26 in the manner and to the extent provided in sections 13 (a) and 15 (a), respectively. The gross income, the deduction under section 201 (c) (7) (A) for wholly tax-exempt interest, and the credit under section 26 (a) for partially tax-exempt interest, are decreased by the appropriate amortization of premium and increased by the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures, or other evidences of indebtedness held by a life insurance company. See section 201 (e) and § 39.201-9. Such companies are not subject to the provisions of section 117 (capital gains and losses) nor to the provisions of section 125 (amortizable bond premium). For computation of the adjusted normal-tax net income from normal-tax net income and the adjusted corporation surtax net income from corporation surtax net income, see §§ 39.202-1, 39.202-2, and 39.203-1. For computation of the 1952 or 1953 adjusted normal-tax net income from the normal-tax net income for such year, see §§ 39.203A-1 and 39.203A-2.



**§ 39.207-1(a) Tax on Mutual Insurance Companies other than Life or Marine Fire Insurance Companies Subject to the Tax Imposed by Section 204.**

(2) The taxable income of mutual insurance companies subject to the tax imposed by section 207 differs from the taxable income of other corporations. See section 207 (a) (2) and section 207 (b). Such companies are entitled, in computing normal-tax net income and corporation surtax net income, to the credits provided in section 26 in the manner and to the extent provided in sections 13 (a) and 15 (a). The gross amount of income during the taxable year from interest, the deductions under section 207 (b) (4) (A) for wholly tax-exempt interest, and the credit under section 26 (a) for partially tax-exempt interest, are decreased by the appropriate amortization of premiums and increased by the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures or other evidences of indebtedness held by a mutual insurance company subject to the tax imposed by section 207. See section 207 (d) and § 39.207-6.

**INTERNAL REVENUE CODE OF 1954.**

**Sec. 1232. Bonds and Other Evidences of Indebtedness.**

(a) [as amended by Sec. 50 of the Technical Amendments Act of 1958, P. L. 85-866, 72 Stat. 1606] *General Rule.*—For purposes of this subtitle, in the case of bonds, debentures, notes, or certificates or other evidence of indebtedness, which are capital assets in the hands of the taxpayer, and which are issued by any corporation, or government or political subdivision thereof—

(1) *Retirement.*—Amounts received by the holder on retirement of such bonds or other evidences of indebtedness shall be considered as amounts received in exchange therefor (except that in the case of bonds or other evidences of indebtedness issued before January 1, 1955, this paragraph shall apply only to those issued with interest coupons or in registered form, or to those in such form on March 1, 1954).

(2) *Sale or Exchange.*—

(A) *General rule.*—Except as provided in subparagraph (B), upon sale or exchange of bonds or other evidences of indebtedness issued after December 31, 1954, held by the taxpayer more than 6 months, any gain realized which does not exceed—

(i) an amount equal to the original issue discount (as defined in subsection (b)), or

(ii) if at the time of original issue there was no intention to call the bond or other evidence of indebtedness before maturity, an amount which bears the same ratio to the original issue discount (as defined in subsection (b)) as the number of complete months that the bond or other evidence of indebtedness was held by the taxpayer bears to the number of complete months from the date of original issue to the date of maturity;

shall be considered as gain from the sale or exchange of property which is not a capital asset. Gain in excess of such amount shall be considered gain from the sale or exchange to a capital asset held more than 6 months.

\* \* \* \* \*

(26 U. S. C. 1958 ed., Sec. 1232)

**U. S. TREASURY REGULATIONS (1954 CODE).**

**§ 1.61-7 Interest.**

(c) *Obligations bought at a discount; bonds bought when interest defaulted or accrued.* When notes, bonds, or other certificates of indebtedness are issued by a corporation or the Government at a discount and are later redeemed by the debtor at the face amount, the original discount is interest, except as otherwise provided by law. See also paragraph (b) of this section for the rules relating to Government bonds. If a taxpayer purchases bonds when interest has been defaulted or when the interest has accrued but has not been paid, any interest which is in arrears but has accrued at the time of purchase is not income and is not taxable as interest if subsequently paid.

Such payments are returns of capital which reduce the remaining cost basis. Interest which accrues after the date of purchase, however, is taxable interest income for the year in which received or accrued (depending on the method of accounting used by the taxpayer).

80TH CONGRESS, 2D SESSION H. R. 6999.  
IN THE HOUSE OF REPRESENTATIVES

JUNE 19, 1948

Mr. HARDIE SCOTT introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To provide for capital-gain treatment with respect to income received on the redemption of certain United States savings bonds.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,* That Section 22 of the Internal Revenue Code (relating to gross income) is hereby amended by adding at the end thereof the following new subsection:

"(o) UNITED STATES SAVINGS BONDS ISSUED AT DISCOUNT.—

"(1) INCREMENT IN VALUE.—In the case of United States savings bonds issued on a discount basis on or after March 1, 1941, under section 22 of the Second Liberty Bond Act, as amended, any increment in value represented by the difference between the price paid and the redemption value received or accrued during the taxable year shall be considered, notwithstanding the provisions of section 22 (d) of such Act, as gain from the sale or exchange of a capital asset held for more than six months.

"(2) CROSS-REFERENCE.—For provisions permitting taxpayer reporting on cash basis to treat increase in redemption price occurring in a taxable year as income received in such year, see section 42(b)."

SEC. 2. The amendment made by this Act shall be applicable with respect to taxable years beginning after December 31, 1947.

**REPORT OF SUBCOMMITTEE OF COMMITTEE ON WAYS  
AND MEANS, 75TH CONG. 3RD SESS. DATED JANU-  
ARY 14, 1938. REPORTED IN HEARINGS ON H. R.  
9682, 75TH CONG. 3RD SESS., p. 38.**

It is important also to emphasize that there is no clean separation in practice, between capital gains and ordinary income; and that the complete exemption of capital gains from income taxes might well stimulate the conversion of other types of income into the form of capital gains. For instance, mortgages, land contracts, etc., are frequently sold at substantial discounts. From a statutory standpoint, the difference between the principal amount and the purchase price is regarded as a capital gain; but from an economic standpoint the discount is merely the means whereby the effective annual yield of the instrument is raised from, say, 6 per cent to 12 or 15 percent. A bond purchased at a premium results in a capital loss when redeemed at par, and a bond purchased at a discount, in a capital gain. Yet it is the everyday practice in investment circles to quote both these types of bonds in terms of their effective yields to maturity or call date. Consequently, elaborate provisions in the statute, the effective administration of which would be impossible or extremely difficult, would be necessary, if the income tax were removed from capital gains, in order to prevent widespread avoidance of the income-tax burden through manipulation of ordinary income into the guise of capital gain.

**CONGRESSIONAL RECORD—SENATE.**

**June 4, 1929.**

\* [p. 2319] **AMENDMENT OF SECOND LIBERTY BOND ACT**

Mr. Smoot. Mr. President, I ask unanimous consent that the pending unfinished business may be temporarily laid aside and that the Senate proceed to the consideration of the bill (H. R. 1648) to amend section 5 of the second Liberty bond act, as amended. The Senator from Michigan [Mr. Couzens], because of whose absence on a previous occasion the bill was temporarily laid over, is now present.

The President pro tempore. Is there objection to the request of the Senator from Utah?

There being no objection, the Senate, as in Committee of the Whole, proceeded to consider the bill.

Mr. Couzens. Mr. President, the House bill having been substituted for the Senate, and being a short bill, I think it ought to be read, because I think it is of considerable importance.

The President pro tempore. The bill will be read.

The Chief Clerk read the bill, as follows:

*Be it enacted, etc.,* That section 5 of the second Liberty bond act, as amended (U. S. C., title 31, sec. 754), is hereby amended to read as follows:

"Sec. 5. (a) That in addition to the bonds and notes authorized by sections 1 and 18 of this act, as amended, the Secretary of the Treasury is authorized to borrow from time to time, on the credit of the United States, for the purposes of this act, to provide for the purchase or redemption before maturity of any certificates of indebtedness or Treasury bills issued hereunder, and to meet public expenditures authorized by law, such sum or sums as in his judgment may be necessary, and to issue therefor (1) certificates of indebtedness of the United States at not less than par and at such rate or rates of interest, payable at such time or times as he may prescribe; or (2) Treasury bills on a discount basis and payable at maturity without interest. Treasury bills to be issued hereunder shall be offered for sale on a competitive basis, under such regulations and upon such terms and conditions as the Secretary of the Treasury may prescribe, and the decisions of the Secretary in respect of any issue shall be final. Certificates of indebtedness and Treasury bills issued hereunder shall be in such form or forms and subject to such terms and conditions, shall be payable at such time not exceeding one year from the date of issue, and may be redeemable before maturity upon such terms and conditions as the Secretary of the Treasury may prescribe. Treasury bills issued hereunder shall not be acceptable before maturity in payment of interest or of principal on account of obligations of foreign governments held by the United States of



America. The sum of the par value of such certificates and Treasury bills outstanding hereunder and under section 6 of the first Liberty bond act shall not at any one time exceed in the aggregate \$10,000,000,000.

"(b) All certificates of indebtedness and Treasury bills issued hereunder (after the date upon which this subdivision becomes law) shall be exempt both as to principal and interest, and any gain from the sale or other disposition thereof shall be exempt from all taxation (except estate or inheritance taxes) now or hereafter imposed by the United States, or by any local taxing authority; and no loss from the sale or other disposition thereof shall be allowed as a deduction or otherwise recognized for the purposes of any tax now or hereafter imposed by the United States or any of its possessions.

"(c) Wherever the words 'bonds and notes of the United States,' or 'bonds and notes of the Government of the United States,' or 'bonds or notes of the United States' are used in the Federal reserve act, as amended, they shall be held to include certificates of indebtedness and Treasury bills issued hereunder."

Mr. Couzens. Mr. President, the Finance Committee considered the bill (S. 310) to amend section 5 of the second Liberty bond act, as amended, for which the pending House bill has been substituted. I think the bill has a great deal of merit, and I approve of all of it substantially, except subsection (b) in section 5, which refers to the exemption from taxation of certificates of indebtedness or Treasury bills. It exempts from taxation all capital gains in transactions relating to them.

All capital gains from transactions in any security are now subject to the income tax. Efforts have been made from time to time, and strenuous efforts are now being made to exempt capital gains from income taxation. The movement is particularly energetic at this time because of the great gains which have been made on the New York Stock Exchange. It may be said that literally hundreds of millions of dollars have been made in transactions on the

stock-exchange. If Congress should adopt the principle of exempting from taxation capital gains, the Government will have its revenue materially cut.

Mr. Smoot. Mr. President, will the Senator from Michigan yield to me?

The Vice President. Does the Senator from Michigan yield to the Senator from Utah?

Mr. Couzens. I yield.

Mr. Smoot. I think the Senator from Michigan will agree with me that there is no inclination whatever, so far as the members of the Finance Committee are concerned, to adopt such a program. I know at this time, as the Senator has stated, that there is pressure being brought to bear from some sources to exempt all capital gains from taxation, but, so far as the Finance Committee is concerned, I do not know of a single member of that committee who would vote for such a proposition.

Mr. Couzens. Mr. President, notwithstanding what the Senator from Utah says, I have been here long enough to know that men change their minds. Under pressure I have known many Senators to change their minds. Minds may be changed now or changed later with respect to the taxation of capital gains.

Mr. Fletcher. Mr. President—

The Vice President. Does the Senator from Michigan yield to the Senator from Florida?

Mr. Couzens. I yield.

Mr. Fletcher. Why should we now exempt the certificates and bills provided for in this bill from capital-gains taxation?

Mr. Couzens. That is the very question I raised in the Finance Committee. I objected then, and I here now object to an entering wedge of any kind which would exempt from taxation capital gains, no matter on what sort of securities they might be made.

[p. 2320] Mr. Smoot. Mr. President—

The Vice President. Does the Senator from Michigan yield further to the Senator from Utah?

Mr. Couzens. I yield.

Mr. Smoot. I think the Senator went even further than that. As I understand the Senator's position is this: He would like to have stricken out the language:

Any gain from the sale or other disposition thereof shall be exempt from all taxation.

Those are the words the Senator desires to be stricken out.

Mr. Couzens. Those are the words to which I particularly object.

Mr. Smoot. As to the bills themselves, and as to the Treasury certificates, they are exempt, and the provision just read by me refers to the gain that may accrue from them. The bill makes no other change, I will say to the Senator.

Mr. Fletcher. That is precisely the point. I think the Senator from Michigan is right about it.

Mr. Couzens. That is precisely the point I make. This is the first attempt to exempt any form of security from capital-gain taxation.

Mr. Edge. Mr. President—

The Vice President. Does the Senator from Michigan yield to the Senator from New Jersey?

Mr. Couzens. I yield.

Mr. Edge. The object is perfectly obvious, is it not, that the bills will bear a rate of interest that much lower?

Mr. Couzens. That argument is a very fallacious one, because the States can come in and claim the same exemption in the case of their securities. In other words, if the capital gain on these bills should be exempted from taxation there is no reason why every other Federal security and State and municipal securities should not have a similar exemption from capital-gain taxation.

Mr. Smoot. Mr. President, will the Senator yield?

The Vice President. Will the Senator from Michigan yield further to the Senator from Utah?

Mr. Couzens. I yield.

Mr. Smoot. I think there is one reason, I will say to the Senator, namely, that these are short-term bills.

Mr. Couzens. Oh, yes.

Mr. Smoot. They would not be issued for longer than three months, and, more than likely, the Treasury would be in a position to take them up within 30 days after they were issued, or, at any rate, within 60 days, and in no event can the period exceed three months.

As Senators know, there are four dates on which income taxes are paid, namely, March 15, June 15, September 15, and December 15. These certificates and bills will be purchased in the market and the proceeds will be used to cover the expenses of the Government so that the Government will not have to issue bonds and will be able to save the amount of interest which would accrue between the time that the certificates or the bills shall be issued and the end of the respective periods when the income-tax payments are due.

Mr. Glass. Mr. President—

The Vice President. Does the Senator from Michigan yield to the Senator from Virginia?

Mr. Couzens. Before I yield to the Senator from Virginia I wish to say that the argument the Senator from Utah is making does not touch the issue at all. There have not been very many occasions when I could commend the Treasury Department, but on this occasion I want to commend that department for suggesting this plan of short-time financing. I think it is a very commendable plan; but I disagree with the feature which has been injected into it and which has nothing whatever to do with the financial scheme properly considered of exempting capital gains from taxation.

Mr. Smoot. The Senator will admit, will he not, that if the bills were exempt so far as capital-gains taxation is concerned, the Government could purchase the money through these bills a little cheaper than it otherwise could?

Mr. Couzens. That may be said with respect to all Federal obligations. Why not exempt them all? I contend that this is merely an entering wedge in an effort to exempt capital gains from taxation. There is no more reason why these Treasury bills should be exempted from capital-gains taxation than that Liberty bonds or other obligations of the Federal Government should be so exempted.

Mr. Glass. Mr. President—

Mr. Smoot. There is only this reason—

The Vice President. Does the Senator from Michigan yield; and if so, to whom?

Mr. Couzens. I yield to the Senator from Utah in order that he may finish what he desires to say.

Mr. Smoot. I say that the only reason is that these are very short-time bills. I agree with the Senator as to the exemption of capital gains in the case of obligations that the Government has already issued and on which capital-gains taxes are paid, and I would not care if the principle were extended further; but, as I have said, the life of the Treasury bills under this measure will not on the average be more than 45 days. They will be sold in the open market, as I have already stated, and the Treasury Department thinks at least—and I rather agree with them—that with this provision in the bill they may be able to obtain money for the short periods of time desired at a little less rate and perhaps make more than would be gained by taxing capital gains which might accrue upon the bills.

Mr. Couzens. I do not agree with the Senator from Utah in that respect. The Federal Government could borrow all the money it needs at a less rate if it exempted capital gains from taxation. It could borrow all of its money at a much less rate if it exempted its securities from all taxation, as State and municipal bonds are exempted.

Mr. Glass. Mr. President.

The Vice President. Does the Senator from Michigan now yield to the Senator from Virginia?

Mr. Couzens. I do.

Mr. Glass. Mr. President, I wish to ask both Senators whether or not the committee considered another aspect of this question which, in my view, is very much more serious than the tax phase of it, and that is the use of these short-time certificates for stock-gambling purposes.

It is a very well-known fact that in this frightful orgy of speculation which has almost paralyzed the legitimate commercial and industrial credits of this country, the speculators have been enabled to operate excessively and



with facility because of a provision of the Federal reserve act that permits direct borrowings by the banks under the 15-day clause of that statute. It is now proposed to issue short-time certificates which will facilitate that sort of activity by the stock gamblers, which will enable them to buy from day to day these short-time certificates and have them rediscounted at the Federal reserve banks, and thus manipulate the credits of the Government in order to increase the credits of the stock gamblers.

Mr. Couzens. Mr. President, I should like to say to the Senator in that connection that I think he has not carefully considered the bill, for the reason that this provision does not provide for additional financing. It simply substitutes a non-interest-bearing certificate for an interest-bearing certificate. In other words, there is no additional financing whatever.

These bills, when sold, will be sold without any interest rate whatever. They will be sold by competitive bidding; and whatever interest the purchaser secures is the difference between the value of the certificate at maturity and the price he pays for it. That is substituted in place of the present short-time certificate issued for 3, 6, or 9 months or a year at an interest rate of 3 or  $3\frac{1}{2}$  or  $4\frac{1}{2}$  per cent, or whatever the rate may be. It seems to me there is every advantage in substituting this form of financing the Government for the present form.

Mr. Glass. Oh, I concede that that would be so for the Government's operations.

Mr. Couzens. But it makes no difference in the volume.

Mr. Smoot. They have to pay for the certificates.

Mr. Glass. But a speculator can obtain these short-time certificates for use in the rediscount market with greater convenience and facility to himself than he could obtain United States bonds.

Mr. Couzens. Oh, no, no; that is not the question, Mr. President. The Treasury officials are now issuing, as the Senator knows, certificates of indebtedness, and they are available to the speculator in every way.

Mr. Glass. I know they are, and that is what I am complaining of.

Mr. Couzens. These are no different.

Mr. Glass. But here we are multiplying the facilities for that very sort of thing.

Mr. Couzens. Oh, no; the Senator is all wrong in regard to multiplying the facilities.

Mr. Glass. As a matter of fact, we ought to repeal the wartime provision—because it was put there under the pretense that it was a war necessity—of the Federal reserve act that enables these gamblers to use the credit of the United States Government for their purposes.

Mr. Couzens. I have no objection if the Senator will propose that. That, however, is an entirely different proposition than the one we now have before us: If the Senator will introduce a bill proposing the repeal of the section of which he complains, I shall be very glad to support his efforts.

Mr. Glass. I am going to do that.

\* \* \* \* \*

[There followed a debate on the wisdom of a capital gains tax, the Federal Reserve System and the stock market.]

[p. 2328]. Mr. Couzens. Now we come back to the business before the Senate. On page 3 of the bill subsection (b) reads:

All certificates of indebtedness and Treasury bills issued hereunder (after the date upon which this subdivision becomes law) shall be exempt, both as to principal and interest, and any gain from the sale or other disposition thereof shall be exempt from all taxation.

In line 3, page 4, I move to strike out the words "and any gain from the sale or other disposition thereof shall be exempt from all taxation." I offer that as an amendment to the bill.

I want to say in this connection that to the other features of the bill I have no objection and I believe that the passage of the bill with that exception will save much

money to the Government in its refinancing operation.  
 Mr. McKellar. Mr. President, may we have the clerk state the amendment?

Mr. Couzens. I will restate it for the Senator. If the Senator will look at page 3 of the bill, in line 4, he will see there the words which I have moved to strike from the bill, as follows:

and any gain from the sale or the disposition thereof shall be exempt from all taxation.

If those words are stricken from the bill, so far as I am concerned, the bill is all right.

[p. 2329]. The Vice President. May the Chair call the Senator's attention to the fact that the words "from all taxation" in line 5 applied to the words preceding those which the Senator desires to strike out?

Mr. Couzens. The present bonds are all tax exempt. There are other bonds that have been issued that are tax exempt in limited amounts. As respects those matters I do not particularly object to them being tax exempt so far as anything is concerned except the capital gain. In other words, I have no objection to the Federal bonds being exempt from taxation to the same extent that State and municipal bonds are exempt. I will support any other amendment that anybody else chooses to offer in that connection, but I believe that Federal bonds should be on the same basis as State and municipal bonds. I confess to the fact that the Chair is right, that this is a diversion from the usual principle of taxing these bonds.

The Vice President. The question is on agreeing to the amendment submitted by the Senator from Michigan.

Mr. Smoot. Mr. President, the Treasury Department is very anxious that those words remain in the bill. That part of the bill is one which was perhaps most discussed before the committee. The committee as a whole, with the exception of the Senator from Michigan, thought that it was the proper thing to leave those words in the bill. Instead of costing the Government any money it will, in my opinion, save the Government thousands and tens of thousands of dollars. However, I want the Senate to ex-

press its opinion and I have no objection to a vote upon the item, if the Senators wants the yeas and nays.

Mr. Couzens. I want to make one exception to what the Senator from Utah just said. The Senator said the Treasury Department was exceedingly anxious to have that language retained in the bill. Mr. Ogden Mills did not strenuously urge that the language be retained in the bill because it was pointed out that bills of acceptance and other financial transactions in the market do have to pay a capital-gain tax and it was pointed out there was no more intricacy involved in these cases than in this case. There is no urgency on the part of the Treasury Department, so far as it was represented by Mr. Mills before the committee, that the specific language be retained in the bill.

Mr. Smoot. There is no question in my mind but what the administration of the collection of the tax is just as simple on this as on any other bond or certificate issued by the Government of the United States. That question is not involved. The only question for the Senate to decide is whether it would be money in the pockets of the Government to sell these bills with an average life of not to exceed 45 days tax exempt from the gains that may be made upon them, or whether it shall sell them and then let the profits that are made upon them be exempt from taxation. That is all there is to it. It is only a matter of opinion. I hope the Senate will take a yea-and-nay vote on it.

Mr. Couzens. Of course, the Senator is only making an assumption when he says 45 days.

Mr. Smoot: I used what I believe to be the average.

Mr. Couzens. That is not the question. It may be a much longer period than 45 days.

Mr. Smoot. It could not be unless we increased the amount of our obligations. If the Government of the United States got into a position whereby we had to increase our obligations over what they are to-day, then I could not say that; but we know that as long as there is a decrease every year in the outstanding obligations of the



Government, the certificates will be less each year and the life of them would be only between the sale date and the end of the three months. I took the average. It may be 50 days, or it may be 60 days, or it may be 40 days.

Mr. Couzens: Does not the Senator agree that there is now an effort under way to have Congress repeal all of the capital-gain tax?

Mr. Smoot. That has been true ever since we passed the first bill imposing a tax upon capital gains. The Senator is right, but there is no inclination on the part of the Finance Committee of the Senate or the Ways and Means Committee of the House to do such a thing. There is propaganda to have us do so and I am perfectly aware of it, and it will be kept up as long as anyone is compelled to pay that tax; but, in my opinion, the day will not come when Congress will act favorably on any such propaganda.

Mr. Couzens. Is it not true that the Treasury Department on several occasions recommended the repeal of the capital-gains tax?

Mr. Smoot. I think there were two occasions in our hearings when the question arose, and there was an expression on the part of some of the members of the Treasury Department to the effect that if that were done the Government of the United States would lose no money.

Mr. Couzens. If that entering wedge is permitted to become effective to exempt any form of security from capital-gains tax, every Senator knows that it will be used as an argument by every agency that desires a repeal of the capital-gain tax.

Mr. Smoot. It would have no effect whatever on anybody who knew the workings in the department. These bills are not to draw interest. They are to be bought outright. If anyone did buy these bills at  $99\frac{7}{8}$ , we will say, and sold them at 100, there would be that profit of one-eighth. Whether they can do it or not depends entirely upon the money market. I think it is unnecessary, but I am not going to make any special fight over it.

Mr. Reed. Mr. President—



The Vice President. Does the Senator from Utah yield to the Senator from Pennsylvania?

Mr. Smoot. I yield.

Mr. Reed. I think we ought to bear in mind that at the present time all of these certificates of indebtedness and Liberty bonds are absolutely tax free in the hands of the corporations—

Mr. Couzens. Not as to capital gain.

Mr. Reed. Wait a minute. The interest on certificates of indebtedness, on Treasury notes, and on Liberty bonds is absolutely tax free when they are held by a corporation.

Mr. Smoot. That is true.

Mr. Reed. If the Treasury wants to issue \$100,000 of 4 per cent certificates with coupons attached for the payment of the interest, no bank or corporation that holds those notes—and most of them are held by corporations—is subject to one penny of tax thereon. The Treasury bills are intended to take the place of short-term Treasury certificates. In order to prevent the necessity of selling them at a flat price fixed in advance by the Treasury, or somewhat under the market in order to make sure they will sell, the Treasury has invented this idea of Treasury bills, somewhat similar to those now used in Great Britain by the Exchequer, in which they sell non-interest-bearing bills at a discount, exactly the same as a bank discounts a 30-day note which is payable at the end of 30 days without any interest. There is an apparent capital gain when a bank buys a 30-day note at a discount, but actually that capital gain represents the hire of the money for the interval that elapses between the purchase and the maturity date.

Mr. Couzens. The Senator has made two statements—

Mr. Reed. I have made more than that.

Mr. Couzens. I know he has made many more than that, but he has made two statements which I am afraid are misleading. In the first place, he said that certificates of indebtedness and Federal bonds held by corporations and banks are nontaxable.

Mr. Reed. The interest on them is nontaxable. That is correct.

Mr. Couzens. We are not discussing interest. We are discussing capital gain. The inference goes out that the bonds are not taxable in the hands of corporations. I contend that if there is a capital gain, they are taxable in the hands of a corporation.

Mr. Reed. Precisely; and there the Senator puts his finger on the difference. If there is a capital gain in a transaction involving a 4¼ per cent Liberty bond, that is a true capital gain, and it is not interest. The coupon represents the interest on that investment. These certificates are to have no coupons, and ordinarily the capital gain in the five or six weeks that they would be held would represent the interest. It is the hire for the use of the money.

Mr. Couzens. Before the Senator proceeds further, I want to correct him in one respect. The Senator creates the impression that there can be no capital gain because it is all interest. If I buy one of those bills due September 1, 1929, and I buy it at 98 and sell it to-morrow at 99, there is a capital gain not represented by the interest to which the Senator has referred.

Mr. Reed. Of course there is.

Mr. Couzens. I say the statement is misleading because it is not all interest. It depends upon the time that elapses between the issuance of the security and the date of maturity.

Mr. Reed. If the Senator wants to imagine such an extravagant illustration as that a Treasury bill will appreciate 1 point in the course of a day or a week even, of course in such an illustration there is a capital gain in excess of the amount of the interest paid for the use of the money. But if the Senator will bear with me for a moment, I want to show what the effect of the amendment would be.

This would be the practical effect of the amendment: I personally do not care a rap whether the tax-exempt feature remains in the bill or not; but if we are going to make interest on Treasury certificates tax exempt—and that is what we have [p. 2330] done, because no corporation pays a penny of tax on certificate coupons—then there

is no sense in providing for Treasury bills at all. If a corporation knows that it is going to have to pay a tax on the amount of the discount at which it purchases the Treasury bills under par—whether we regard it as a capital gain, as my friend from Michigan does, or whether we regard it as the hire of the money, as I do, does not make a particle of difference—no bank is going to buy Treasury bills on the same interest basis on which it will buy Treasury certificates, because one is free from tax and the other is subject to 11 per cent tax on all that gain. So there would be no use of initiating the system of Treasury bills if we are going to tax the fractional appreciation in the value. Banks will not buy them or else they will buy them at a discount, which is that much greater, so as to take care of the tax. We are just beating the devil around the bush if we try to make that fraction taxable because we have to pay it to the bank, and then we go and tax the bank and get it back to ourselves. We had better get the advantage of the lower discount rate.

The Vice President. The question is on agreeing to the amendment proposed by the Senator from Michigan [Mr. Couzens].

Mr. Couzens. Mr. President, I wish to answer the Senator from Pennsylvania [Mr. Reed]. He is a very plausible debater, and what he says is substantially correct, except that to eliminate this provision would not defeat the purposes of the Treasury Department. All of the advantages that the Treasury Department would get under this proposed law will still be retained, even with the amendment which I propose, except a possible slight difference in the interest rate because of the fact that the banks may have to pay on the capital gain; but that is all problematical. The Undersecretary of the Treasury stated before the Finance Committee that the same identical bills of indebtedness, when traded in commerce, are subject to a profit tax. When a bill is traded in commerce, an acceptance, or what not, if there is a capital gain, it is taxed. There is no difference whatever. Whether or not we take the money out of one pocket and put it into the other, the

fact is that if we shall adopt the principle of exempting securities from the capital-gain tax we shall establish a principle which will return to plague us so long as we have the capital-gain tax on the statute books.

Mr. Reed. Is there not this distinction: When we tax a bank on the amount it receives in discounting John Smith's 30-day note we are getting the money either from the borrower or the lender; the Government does not pay out the money and immediately get it back, but in this case the Government is the borrower, the maker of the note, and, therefore, I do not see any sense in paying out extra interest and immediately taking back the same money in additional taxes?

Mr. Couzens. In that event why should we not make all of the Government securities exempt from the capital-gain taxation? In other words, if the Government is selling certificates of indebtedness or Federal bonds on which there are no taxes on capital gains, unquestionably we could get a better price for them.

Mr. Reed. If I had my way, there would not be any tax-exempt bonds at all. The Senator from Michigan asked me that question; but that is not practicable now, because we have put that law into effect and can not repeal it without breach of faith. However, so long as we have a great mass of \$17,000,000,000 of outstanding securities, the interest on which is tax exempt, in the hands of corporations, and if we desire the securities to be issued under this bill to compete with the others and sell on the same interest basis, we have got to give them the same privilege.

Mr. Couzens. If the Senator is correct, there is not any reason why we can not repeal the law which makes the income on other Federal securities taxable.

Mr. Reed. The Senator does not mean that we can tax Liberty 3½ per cent bonds, for example?

Mr. Couzens. No; I am saying just the reverse. I am saying that there is nothing in the world to prevent Congress from repealing the law which makes other Federal bonds taxable; I do not mean the tax-exempt bonds, but those that are taxable.

Mr. Reed. Yes; there is. If we issued all our Liberty bonds and Treasury notes and Treasury certificates—

Mr. Couzens. And they are all taxable.

Mr. Reed. With the stipulation that they shall be wholly exempt from the normal tax.

Mr. Couzens. I am not talking about the normal tax.

Mr. Reed. The normal tax is all a corporation pays.

Mr. Couzens. I am talking about capital gains. If it is desired to exempt these securities from the capital-gain tax, why not exempt all other Federal securities from the capital-gain tax?

Mr. Reed. Because what the Senator calls capital gain here is really the hire of money; and that is not true of the others; they carry coupons.

Mr. Couzens. But the principle is exactly the same. If there was not an advantage in having the capital-gain tax provision not apply to these securities, it certainly would not be included in the bill. The Senator from Pennsylvania shakes his head, but why does he want this provision in the bill if there is not some advantage to the Government from it?

Mr. Reed. The advantage to the Government is obvious. It is going to have to pay 11 per cent more interest in the way of discount on these bills unless it makes them tax exempt.

Mr. Couzens. So, for the purpose of getting this saving immediately to the Government, the Senator would adopt the principle of waiving the tax on capital gains?

Mr. Reed. Not at all; I am not in favor of waiving the tax on capital gains. In the present condition of affairs it can not fairly be done. I did think a few years ago that the Government would save a great deal of money if it would disregard capital gains and losses, because there were always more losses reported than there were gains. That has not been so since 1924, and I join with the Senator in opposing the repeal of the capital-gains tax now, although I do think that, as it stands, it is a very clumsily arranged tax; it can be improved; but I agree with the Senator that the principle of taxing capital gains must be maintained for many years yet to come.



Mr. Walsh of Montana. Mr. President, I can not believe that the clause in question in this bill relates to such a condition as that suggested by the Senator from Pennsylvania. Of course, if the Treasury discounts its bills the same as the private individual discounts his bills at a bank, the difference between the amount that he pays for the bill and the par value of it is unquestionably the interest which comes to him. I apprehend that no one wants to subject that interest—that is to say, that difference—to taxation; but here is a man who buys one of these bills in a tight market, occasioned, perhaps, by the draining of available funds into the gambling market of which we have been speaking, so that the Government is obliged to sell at a rather high discount. After a time, however, the situation eases and that man sells his bill to someone else and makes a gain on it. I take it that the provision of the bill which the Senator from Michigan seeks to excise refers to gains made by him upon the sale of that bill.

Mr. Reed. That is what the Senator has been speaking of.

Mr. Walsh of Montana. Just as one who bought stock at a certain figure and subsequently sold it at an appreciation would be obliged to include in his income-tax return whatever he made by the sale of the stock, why should he not be obliged to return what he made by speculating in the Government's bills, just as he would be speculating or investing in any other bills?

Mr. Reed. If the Senator will look at the opposite page of the bill he will see that the new matter which it contains is the provision in line 6, on page 2, which provides that Treasury bills may be issued on a discount basis.

Mr. Smoot. Without interest.

Mr. Reed. It is to prevent that discount being taxable that the words were inserted on page 3 which the Senator from Michigan is now trying to strike out.

Mr. Walsh of Montana. I do not think they are non-taxable for that reason at all. They are nontaxable, it seems to me, by reason of the further provision which

forbids the taxing of the interest, because, as I have indicated, in my judgment, the difference between the sale price and the par value of the bill, is not a gain from the sale at all but is the actual interest upon the money which is turned into the Treasury.

Mr. Reed and Mr. Couzens addressed the Chair.

The Vice President. Does the Senator from Montana yield; and if so, to whom?

Mr. Walsh of Montana. Just a moment. Is it not always the case with a bill which is discounted at a bank that the difference between the amount realized by the maker of the bill and the face of the bill is what he pays in interest?

Mr. Reed. Yes; and that is what I have been arguing.

Mr. Walsh of Montana. Exactly.

Mr. Reed. And it is to make that difference nontaxable that these words were put in.

Mr. Walsh of Montana. It is nontaxable by reason of the provision of the bill that—

All certificates of indebtedness and Treasury bills issued hereunder \* \* \* shall be exempt, both as to principal and interest.

That is the whole thing—the principal is exempt. If a man buys at a discount of 4 per cent, he pays 96 for every \$100 of face value; he pays \$96, which is his principal, and the difference between that and \$100 is his interest. He does not pay upon the \$96 and he does not pay upon the \$4 if he gets it; [p. 2331] but if in the meantime he sells the bill to someone at 99, having paid only 96, then he makes a profit of 3 per cent; and why should he not be taxed on it?

Mr. Reed. Suppose he has held it for three-quarters of its life and sells it at 99?

Mr. Walsh of Montana. Very well. He will then take credit for three-quarters of 4 per cent.

Mr. Reed. That is the businesslike way of doing it; but under the present regulations of the Bureau of Internal Revenue the whole amount would be considered to be capital gain.

Mr. Walsh of Montana. It is a very easy thing to figure out how much of the appreciation is interest upon his investment and how much is actual gain by reason of the sale.

Mr. Smoot. Mr. President—

Mr. Couzens. Mr. President, will the Senator yield?

The Vice President. Does the Senator from Montana yield; and if so, to whom?

Mr. Walsh of Montana. I yield first to the Senator from Utah.

Mr. Smoot. Mr. President, the theory of the bill is that if the bills are tax exempt, the Government of the United States can make more out of their sale because of a lesser rate of interest than it can by taxing capital gain if a profit should be made. No interest is involved in it at all; there is no interest to be collected on the bills; they are sold without interest; and the Secretary of the Treasury believes that with the words which have been referred to in the bill the Government will get more for the securities than if it imposed a tax upon whatever the interest might be.

Mr. Walsh of Montana. I understand that perfectly well; but if I discount a bill for \$100 at the bank, and I get only \$96, I am paying 4 per cent interest, or substantially 4 per cent; and the difference between the \$96 and the \$100 is interest. It can not be designated in any other way, and that is the way it is understood. So when the Treasury discounts its bills at 4 per cent, that 4 per cent represents the interest which the Government pays.

If the interest is exempt, as provided in the bill, and the principal is exempt, as provided in the bill, if the purchaser of the bill sells it meanwhile, and makes a profit on his sale, why should not that profit be taxable just the same as the profit he makes on the sale of stocks or anything else?

Mr. Couzens. Mr. President, if the Senator will yield to me, is not this a simple illustration? If the Government sells to you a \$1,000 bond or certificate of indebtedness on a 4 per cent basis, and you turn around and sell it on a 3 per cent basis, the difference is profit.

Mr. Walsh of Montana. Unquestionably.

Mr. Couzens. That is the simple way of putting it. In other words, if the Government sells the certificate to one individual on a 4 per cent basis, and he turns around and sells it on a 3 per cent or 2 per cent basis, the difference is profit.

Mr. Walsh of Montana. Exactly. I want 4 per cent on my money, and I buy the bill; but I find someone who is perfectly content with 2½ per cent, and he will offer me a premium for it.

Mr. Reed. Mr. President, it seems to me these questions have brought the issue down to the real point. What actually happens in the case of the transaction described by the Senator from Montana is that a negotiable instrument is bought at one price, and subsequently sold at another; and the profit, taken in connection with the time the bill is held, is a capital gain which is the equivalent of interest on that money.

Mr. Couzens. Oh, no!

Mr. Reed. It is just a matter of definition. Please indulge me until I finish the thought. Now, if we can agree that the amount of the discount at which the bill was originally sold shall be considered as interest, and that that shall be nontaxable, while at the same time any transactions relating in capital gains pending the maturity of the certificate should be taxed, I think we should all be agreed on the situation. All the Treasury wants is to make that which is in good faith the equivalent of interest tax free, as it is to-day on Treasury certificates; and I understand that the Senator has no objection to that.

Mr. Walsh of Montana. Not at all. We are agreed about what ought to be done. It is simply a question as to the language in which our views ought to be expressed.

Mr. Reed. It is merely a matter of expressing that thought clearly; and we ought to be able to agree on that.

\* \* \* \* \*

[There followed a discussion of the new Treasury bills and of tax free exchanges.]

[p. 2332] Mr. Couzens. I think we have practically reached an agreement as to language which may be substituted for subsection (h). I will send it to the desk, if the Senator will permit, and have it read.

Mr. McKellar. I am happy to know the Senator has been successful in that.

Mr. Couzens. I think we have arrived at an agreement on language which will suit everybody.

Mr. Smoot. The language is perfectly satisfactory to me.

Mr. McKellar. Let the clerk read it.

The Vice President. The clerk will read the amendment.

The Legislative Clerk. On page 3, to strike out lines 1 to 11, inclusive, and insert in lieu thereof the following:

[p. 2333] (b) All certificates of indebtedness and Treasury bills issued hereunder (after the date upon which this subdivision becomes law) shall be exempt, both as to principal and interest, from all taxation (except estate and inheritance taxes) now or hereafter imposed by the United States or by any local taxing authority; and the amount of discount at which Treasury bills are originally sold by the United States shall be considered to be interest within the meaning of this subdivision.

Mr. McKellar. I am of the opinion that that will correct the situation.

Mr. Couzens. That accomplishes the purpose we have been trying to accomplish.

Mr. McKellar. I think so.

Mr. Couzens. It leaves out all reference to capital gains, so that if a security sold by the United States is held to maturity, the gain is considered as interest, and is, therefore, under the law, tax exempt, but if there is any transaction in the particular note or security afterwards in which the interest rate changes, or in which there is a gain, that gain is taxable under the existing law. To offset that, we had to eliminate from the bill reference to the deduction of losses.

Mr. Smoot. I have no objection.



The Vice President. Does the Senator from Michigan withdraw his other amendment?

Mr. Couzens. I withdraw that, and offer this as a substitute.

\* \* \* \* \*

The Vice President. The question is on agreeing to the amendment offered by the Senator from Michigan.

The amendment was agreed to.

The bill was reported to the Senate as amended, and the amendment was concurred in.

The amendment was ordered to be engrossed and the bill to be read a third time.

The bill was read the third time and passed.

#### SPECIAL RULING—1948.

"Further reference is made to your letter dated May 19, 1948, in regard to the treatment for income tax purposes of the increment on non-interest bearing bonds.

"You refer to section 117(f) of Chapter I of the Internal Revenue Code, which provides, "For the purposes of this chapter, amounts received by the holder upon the retirement of bonds, debentures, notes or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor." Since a gain upon the retirement of a security as described in this section would be subject to tax as a gain on the sale of a capital asset, provided the security itself is a capital asset, you inquire whether the effect of the section is to discriminate against purchasers of United States Treasury savings bonds, the increment of which is subject to surtaxes under the provisions of section 42(b) of the Internal Revenue Code.

"Section 22(d) of the Second Liberty Bond Act (c. 56, 40 Stat. 290), as amended by the Public Debt Act of 1941 (c. 7, 55 Stat. 7), relating to United States savings bonds and United States Treasury savings certificates, provides,

in part, "For purposes of taxation any increment in value represented by the difference between the price paid and the redemption value received (whether at or before maturity) for savings bonds and savings certificates shall be considered as interest." In accordance with this specific provision of law, any increment in value of these securities is not subject to the treatment authorized in the case of certain other securities by section 117(f) of the Internal Revenue Code.

"The difference in the treatment for income tax purposes of non-interest-bearing securities issued at a discount by private corporations and similar securities issued by the Government has been recognized by the courts. See *George Peck Caulkins v. Commissioner* (CCH Dec. 13,006), 1 T. C. 65 (6), affirmed by the United States Circuit Court of Appeals for the Sixth Circuit (44-2 USTC Par. 9416) 144 F. (2d) 482." Quoted at 26 *taxes* 775-776 (1948.)

#### **SPECIAL RULING, AUGUST 7, 1952.**

[Following is the text of a letter to the Commissioner requesting a ruling and the text of a letter dated August 7, 1952, in answer thereto and signed by E. I. McLarney, Deputy Commissioner (symbols, IT:RP:TR-APK-6)]. The letters were distributed by the Committee of Banking Institutions on Taxation, New York, N. Y.

#### **[Request for Rulings]**

We are in receipt of an inquiry concerning the taxation of, and withholding from the income, profits, gains, etc., attributable to:

Bankers' Acceptances,  
Commercial Paper, and  
U. S. Treasury Discount Bills

when owned by nonresident alien entities not engaged in trade or business in the United States. The phrase "non-resident alien entities" herein referred to means non-resident alien individuals, nonresident partnerships com-

posed in whole or in part of nonresident aliens, and non-resident foreign corporations.

In order that we may properly inform our customers and also that we may properly perform our duties as withholding agent, we desire information concerning the situations outlined below:

**Bankers' Acceptances and Commercial Paper Originally Issued at a Discount**

Reference is made to rulings contained in O. 1024 (C. B. 2, 189) and I. T. 1398 (C. B. 1-2, 149) with respect to Bankers' Acceptances. Such rulings state the following principles:

The excess of the proceeds (face value) of bankers' acceptances at maturity over their cost to the holder at maturity is not interest.

Gains and profits derived from purchase and sale of bankers' acceptances are not fixed or determinable, annual or periodical income and consequently are not subject to the withholding of Federal Income Tax at source.

Are we correct in drawing the following conclusions in regard to Bankers' Acceptances and Commercial Paper:

(1) The excess of the proceeds (face value) at maturity over its cost to the holder is not interest, nor is it fixed or determinable annual or periodical income. Therefore, such excess is not subject to the withholding of Federal Income Tax at source, nor does it constitute taxable income.

(2) The foregoing Paragraph (1) holds true at maturity irrespective of the date of acquisition or the price paid.

(3) Any excess over purchase price from sale before maturity is not interest, nor is it fixed or determinable, annual or periodical income. Therefore, such gain is not subject to the withholding of Federal Income Tax at source, nor does it constitute taxable income.

(4) The foregoing Paragraph (3) holds true irrespective of the date of acquisition or of the price paid.

We are aware of the status of income from Bankers' Acceptances owned by a foreign central bank of issue and are not here interested in this particular situation.

[The ruling requested relative to the status of income derived for bankers' acceptances and commercial paper by nonresident alien entities is reported at 525 CCH ¶ 6161. —CCH.]

#### U. S. Treasury Bills Issued at a Discount

For the purpose of illustration let us assume the following facts:

A \$100,000 Treasury Bill is issued at a discount of \$378 on February 4, 1952 and matures on May 4, 1952.

Valuation Date	Thirty Days' Increment	Incremented Value
Feb. 4, 1952	—	\$ 99,622
Mar. 5, 1952	\$126	99,748
Apr. 4, 1952	126	99,874
May 4, 1952	126	100,000
	—	\$378

Let us further assume that a nonresident alien entity (as referred to on page 1 of this letter) enters the following transactions through its American custodian (a New York bank):

(1) Purchases the Bill on February 4, 1952 at \$99,622 and holds the Bill to maturity when it is redeemed for \$100,000. Are we correct in assuming that the entire increment of \$378 is taxable income and is subject to withholding by the American custodian?

(2) Purchases the Bill on February 4, 1952 for \$99,622 and sells on March 5, 1952 for \$99,748. Are

we correct in assuming that the increment of \$126 is taxable income but is not subject to withholding by the American custodian?

(3) Purchases the Bill on February 4, 1952 for \$99,622 and sells on March 5, 1952 for \$99,750. Are we correct in assuming that of the \$128 gain involved, \$126 is taxable income but is not subject to withholding?

(4) Purchases the Bill on February 4, 1952 for \$99,622 and sells on March 5, 1952 for \$99,740. Are we correct in assuming that whereas the gain was only \$118, the taxable income is \$126 but no withholding is required on the latter amount?

(5) Purchases the Bill on March 5, 1952 at \$99,748 and holds to maturity. Are we correct in assuming that increment of \$252 is taxable income but that withholding will be required on \$378?

(6) Purchases the Bill on March 5, 1952 for \$99,800 and holds to maturity. Are we correct in assuming that whereas the gain involved is \$200, the taxable income is \$252 but that withholding is required on \$378?

(7) Purchases the Bill on March 5, 1952 at \$99,748 and sells on April 4, 1952 for \$99,874. Are we correct in assuming that the increment of \$126 is taxable but is not subject to withholding?

The foregoing questions have been propounded and the assumed answers are predicated on the theory that the original discount (increment) on U. S. Treasury Discount Bills, issued on and after March 1, 1941, constitutes interest under Subsection 754 (b), Title 31, of the United States Code. Moreover, since such discount (increment) constitutes Interest, it is therefore income as defined under Internal Revenue Code Section 211 (a) and 231 (a). It has also been assumed that U. S. Treasury Discount Bills have but one Interest Date which is at maturity. Consequently, if a Bill is sold before maturity, no withholding is required under Internal Revenue Code Section 143.



It has been further assumed that any gains, profits, losses, etc. resulting from the purchase and sale of U. S. Treasury Discount Bills, at values at variance with the Incremented Values (see page 2), do not affect gross income from sources within the United States when realized by nonresident alien entities not engaged in trade or business in the United States.

While we are cognizant of the many demands made upon you, we should deeply appreciate your prompt consideration of the matters contained herein.

Very truly yours.

(Signed)

X Bank

[Bureau's Ruling]

Reference is made to that portion of your letter of February 5, 1952 relating to the status, for Federal income tax purposes, of income derived from United States Treasury bills by nonresident alien individuals, nonresident partnerships composed in whole or in part of nonresident aliens, and nonresident foreign corporations.

This office is in agreement with the assumptions relative to the taxable status of and the withholding of tax from interest on Treasury bills as set forth in the examples numbered 1 through 7 in your letter. However, in any case where the withholding agent has definite knowledge of the actual amount representing interest income to a nonresident alien entity, he may, at his option, withhold the tax under section 143 (b) or 144 of the Internal Revenue Code only from such amount.

Also, the assumptions that the original discount on Treasury bills constitutes interest income, that such bills have but one interest date, the date of maturity, and that gains, profits, losses, etc., resulting from the sale of Treasury bills do not affect gross income from sources within the United States when realized by nonresident alien entities not engaged in trade or business within the United States are correct.

**SPECIAL RULING, MARCH 12, 1952.**

[Following is the text of a letter dated March 12, 1952, distributed by the Committee of Banking Institutions on Taxation, New York, N. Y., and signed by E. I. McLarney, Deputy Commissioner (symbols, IT:RP:TR—APK-6):]

Reference is made to your letter of February 5, 1952, wherein information is requested with respect to the status for Federal income tax purposes of income derived from bankers' acceptances, commercial paper, and United States Treasury Bills by nonresident alien individuals, nonresident partnerships composed in whole or in part of nonresident aliens, and nonresident foreign corporations, not engaged in trade or business within the United States.

You refer to O. 1024, C. B. 2, 189, and I. T. 1398, C. B. 1-2, 149, and ask whether your conclusions are correct that the excess of the proceeds (face value) of bankers' acceptances and commercial paper at maturity over cost to the holder is not interest nor fixed or determinable annual or periodical income irrespective of the date of acquisition or the price paid; and that any excess over the purchase price thereof from sale prior to maturity is not interest nor fixed or determinable annual or periodical income irrespective of the date acquired or the cost.

The conclusions stated above are generally in accord with the position of the Bureau.

The excess of the proceeds of bankers' acceptances and commercial paper at maturity over cost to the holder is not taxable in the hands of nonresident alien individuals not engaged in trade or business in the United States at any time during the taxable year or to nonresident foreign corporations and no withholding of tax is required with respect thereto under section 143(b) or 144 of the Internal Revenue Code. Such excess is also not subject to the withholding of tax when paid to a nonresident partnership composed in whole or in part of nonresident alien individuals. However, the excess over the purchase price of bankers' acceptances and commercial paper from sale prior to maturity although not taxable to a nonresident foreign

corporation and not subject to the withholding of tax, may under section 211(a)(1)(B) as amended by section 213 of the Revenue Act of 1950 be taxable to nonresident alien individuals, even though they are not engaged in trade or business within the United States.

No opinion is being expressed at this time as to the assumptions in your letter relating to Treasury bills issued at a discount as this matter is, at present, being reconsidered by the Office of the Chief Counsel. You will be advised with respect thereto in a later communication from this office.